

with respect to enhanced services.⁶⁴ Moreover, under § 222(b)) of the 1996 Act, all telecommunications are prohibited from using CDNI obtained from another carrier.⁶⁵

Other Elements (¶ 116). The FCC tentatively concludes that subscriber numbers, information sufficient for billing and collection or used in the transmission, routing, or other provision of a telecommunications service, and operator call completion services should be unbundled, and requests comment on the standards for such unbundling. No FCC action is needed to assure access to these features and functions.

First, to the extent "subscriber numbers" means number administration (e.g., assignment of NXX codes), nondiscriminatory access is already assured by industry guidelines and the FCC's intent to establish a number administration entity not affiliated with any industry segment. To the extent this term means directory assistance services, GTE supports the proposals at ¶ 217 of the *NPRM*, as will be explained in comments on those proposals.

Second, with respect to information sufficient for billing and collection, ILECs already are obligated to provide such information on calls passed to IXC's,⁶⁶ and industry standards include the transmission of ANI, the Calling Party Number SS7

⁶⁴ See *Computer III Remand Proceedings*, CC Docket No. 90-623, FCC 91-381, released Dec. 20, 1991, at ¶ 89.

⁶⁵ These limitations, of course, apply only to information that is not available from other sources.

⁶⁶ See, e.g., *Local Exchange Carrier Validation and Billing Information for Joint Use Calling Cards*, 8 FCC Rcd 4478 (1993).

parameter ("CPN"), or both on local and interexchange calls. A competing carrier thus will already have the information needed to route and bill calls.

Third, with respect to operator call completion services, FCC action is unnecessary because ILECs, including GTE, already provide access to such services on a nondiscriminatory basis.⁶⁷ GTE also notes that, in discussing call completion, the *NPRM* misreads § 271 in two respects: that section applies only to the BOCs, not to all ILECs; and, it requires non-discriminatory access to call completion services, not unbundled access to the relevant data bases.

E. Resale.⁶⁸

The FCC seeks comment on two provisions of the 1996 Act relating to resale of telecommunications services. The first, § 251(b)(1), places all LECs under the "duty not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of its telecommunications services." The second, § 251(c)(4), requires ILECs "to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers," subject to reasonable and non-discriminatory constraints, which may include subscriber eligibility limitations. The *NPRM* (¶¶ 172-188, 196-197), seeks to explore the reasonableness of various restrictions or limitations on resale; the application of the 1996 Act's wholesale pricing requirement; and the relationship of that requirement to

⁶⁷ GTE will comment on operator call completion services in its response to ¶ 216 of the *NPRM*.

⁶⁸ This section of GTE's Comments responds to Parts II.B.3 and II.C.1 of the *NPRM*.

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other pricing standards in the legislation.⁶⁹ GTE will address these important issues

below.

- 1. Resale of Below-Cost Services Should Not Be Required.**

Because of state policies requiring "contributions" from some ILEC services to

The FCC also should find that, even if the 1996 Act could be interpreted as requiring resale of below-cost services, it certainly does not force ILECs to provide those services for resale at a further discount. The 1996 Act generally states that wholesale rates must be set on the basis of "avoided cost." § 252(d)(3). By providing a below-cost service for resale, however, an ILEC would not recover enough revenues to cover the total costs of the service. In no rational sense, therefore, can an ILEC be considered to have "avoided" costs if the service does not cover its cost in the first place. In fact, this enforced undercompensation -- to the extent not counterbalanced by other forms of explicit support -- would amount to an unconstitutional taking under the analysis presented in section IV.D, below.

The FCC has long recognized that market entry decisions must be based upon correct economic signals.⁷¹ Consequently, the restriction sought by GTE would not unduly retard the development of *rational* resale competition, and it is temporary in any event. Once rate rebalancing has been completed (*see* section IV.E, *infra*) and universal service support has been made explicit, it would be reasonable to permit resale of below-cost services, as long as the underlying facilities provider continues to receive the explicit universal service support.

⁷¹ See, e.g., *Expanded Interconnection with LEC Facilities*, 7 FCC Rcd 7369, 7429 (1992) ("Direct-cost-based pricing of connection charges, which would make these

2. The 1996 Act Permits Reasonable Limitations on Resale.

The 1996 Act expressly permits reasonable and non-discriminatory limitations on resale. Indeed, § 251(c)(4) acknowledges that states may prohibit a reseller from offering a service "available at retail only to a category of subscribers from offering such service to a different category of subscribers." It follows that the FCC should deem acceptable, and states should be free to implement, reasonable restrictions such as a prohibition on cross-category resale.⁷² Below, GTE discusses a number of such reasonable and, indeed, necessary restrictions:

Services used by a new LEC for internal communications purposes should not be permitted to be obtained at wholesale rates. For a service to qualify for resale (and therefore for the avoided cost discount), a new entrant must resell it to an end user, and cannot simply use the service for its own internal or administrative use.⁷³ Allowing such use would contravene the plain meaning of "resale" as "the act of selling again;

⁷² As a general matter, the FCC should not foreclose *ab initio* any state restrictions on resale. Given the 1996 Act's express acknowledgment that resale restrictions may arise under either FCC or state regulations, it would be both ill-advised and beyond the FCC's power to foreclose state variations in resale policies in the name of uniformity. Should any restrictions prove so extreme as to effectively prevent competition, they may be addressed under § 253.

⁷³ An internal ILEC communications network is not, by its definition, a service that is provided to a retail subscriber, and it is thus not available for resale under the 1996 Act. § 251(c)(4). Any communications provider can establish such a network, and many other types of utilities, such as gas and electric companies, have provisioned such internal networks. New entrants are free to do the same. Indeed, a competing LEC is free to purchase services for its own use out of GTE's retail tariffs. If its volume of use is sufficient, GTE will enter into a contract with negotiated terms with the new entrant, as it does with other high volume retail customers.

specific[ally], the act of selling something bought to a third party."⁷⁴ In the telecommunications market, resale provides the opportunity for carriers to offer competitive services to consumers without building a facilities-based network. If new entrants simply use such services internally, there is no competitive benefit to consumers, and the new entrants would in effect become a privileged class of end user, uniquely entitled to receive discounted services.

Resale policies applied to ILECs should never be more rigorous than those applied to IXCs or any other common carrier service providers. The FCC has a wealth of experience with resale requirements and has previously considered various justifications for limiting resale under certain circumstances.⁷⁵ Any resale limitations that are permissible for other industry segments should be presumed reasonable for ILEC services. Enforcement of inconsistent resale requirements would likely constrain competition, particularly in view of the 1996 Act's promotion of the entry of IXCs, CMRS providers, and ILECs into each others' markets.

The FCC should not be concerned by ILEC efforts to re-price or withdraw services that may be subject to resale obligations (§ 175). State commissions historically used non-cost based pricing policies to achieve valid state policy objectives.

⁷⁴ WEBSTER'S DICTIONARY (2d ed.) at 1208. It should not be difficult for a new entrant to determine what constitutes a prohibited internal use. Definitions of what constitutes a retail, wholesale or resale service found in ILECs' tariffs should resolve any such difficulties. If a requesting carrier is unclear whether a particular use met the standards for resale, it can seek the guidance of the relevant regulatory agency.

⁷⁵ See, e.g., *Proposed Changes to the FCC's Cellular Resale Policies*, 7 FCC Rcd 4006 (1992).

Such policies were tenable in a monopoly environment. However, where ILECs must offer both resale and unbundled, cost-based access, these pricing distortions merely encourage arbitrage and inefficient entry, and undermine support flows. States must be able to allow ILECs to re-price and withdraw services in order to assure fair competition, particularly in advance of universal service reform.

Resale to ineligible subscribers should not be permitted. As the 1996 Act contemplates, the FCC should expressly recognize that it is reasonable to prohibit the resale of a service to subscribers who would not be eligible to take it from the underlying carrier (§ 251(c)(4)). Such a limitation is critical to insuring that Universal Service subsidies directed to particular groups are not diverted to others.⁷⁶ This concern is particularly important prior to completion of the ongoing Universal Service proceeding, which is intended to replace the hidden and implicit subsidies that underlie the vast majority of subscriber restrictions with explicit support mechanisms.

"Services" required to be resold at wholesale rates do not include discounted pricing plans or service packages (see § 175). It is well-recognized that volume discount and similar pricing plans reflect the economic cost savings to the provider of dealing in bulk. Similar savings are evident -- and passed on to purchasers -- in discounted service packages, such as those offering multiple vertical features for a price lower than the individual price of each individual feature. Requiring additional price reductions for services already available at a discount would not promote competition. In context, the 1996 Act's wholesale rate requirement was clearly directed

⁷⁶ Compare § 254(h)(3), which prohibits educational and library recipients of subsidized telecommunications services from reselling those services.

at "retail" services, under the assumption that such offerings typically are not available at a discounted rate. Thus, the failure to mandate any further discount should have no effect on the ability of new entrants to compete in the local exchange market by reoffering volume-discounted services to their customers. Resale in the long distance market has thrived without further discounting of volume pricing plans, and it will do so in the local market as well.⁷⁷

Restrictions on resale of promotional offerings are reasonable. Promotional offerings are one of the primary mechanisms by which service providers compete. Such offerings typically involve introductory rates below standard retail, which are made available for short periods in order to generate new demand for a product. Compelling ILECs to make promotional offerings available to competitors, even if under the same terms and conditions applied other subscribers, would impede competition. As the FCC has recognized in the context of matching tariffs, permitting competitors to copy each other's new service and pricing options would promote collusion and reduce incentives for innovation.⁷⁸ Accordingly, promotional offerings should not be subject to resale at either existing or wholesale rates.

⁷⁷ GTE also notes that, if each discount plan constituted a separate "service" under § 251(c)(4)(A), then state restrictions on ILEC pricing flexibility necessarily would constitute an unlawful barrier to competition under § 253(a). That section prohibits state or local rules that would have the effect of "prohibiting the ability of *any entity* to provide *any . . . telecommunications service*." The term "telecommunications service" is used in both 251(c)(4)(A) and 253(a), and must be interpreted the same in both cases.

⁷⁸ *Policy and Rules Concerning the Interstate Interexchange Marketplace*, FCC 96-123, CC Docket No. 96-61 (released March 25, 1996) at ¶ 28 & n.76.

The 1996 Act's resale requirements do not impose any obligation on ILECs to configure, modify, or customize service offerings to satisfy a competitor's request to resell the newly-created offering. The pro-competitive goals of the 1996 Act are adequately served by the resale of existing offerings. Allowing competitors to impose on the incumbent carrier the costs and burdens of developing specialized offerings would be inimical to full competition and deter the construction of alternative facilities-based networks.

Resale may be reasonably restricted where a particular service offering incorporates proprietary technology. Mandating resale of services employing proprietary technology would undermine the incentive to innovate and constrain the development and deployment of new services. Limiting resale, in contrast, would preserve this important incentive, without significantly diminishing competition.

Resale restrictions that recognize capacity limitations and prevent stranded investment are reasonable. Carriers' obligations to provide service on reasonable request pursuant to § 201 of the Communications Act have traditionally been limited by the availability of facilities, and such conditions routinely appear in FCC-filed tariffs. A similar limitation may reasonably be applied to resale requirements. ILECs should not be required to construct new facilities simply to satisfy a request for resale.

In addition, the risks of stranded investment on the part of incumbents should be minimized. For example, if a new entrant seeks such substantial resale capacity that the ILEC must add facilities, and it agrees to do so, it should also be able to require reasonable terms and conditions such as security deposits, minimum usage and term commitments, and early termination liabilities. These provisions are necessary for the

underlying carrier to be able to manage its network efficiently and reduce costs that would be imposed by excessive instability in the reseller market.

3. Wholesale Rates Must Recover Joint and Common Costs and Any Increased Costs Incurred By Making Services Available for Resale.

In addressing the appropriate level for the "wholesale rates" mandated by § 251(c)(4), the FCC again suggests that the 1996 Act authorizes the FCC to promulgate rules for the states (§ 178). As explained above, this position is deeply flawed, not only as a matter of the plain meaning of the statute and Congress' express intent, but also as a matter of sound public policy. Thus, the FCC should not establish national "principles for the states to apply" in order to determine wholesale prices (§ 179).⁷⁹

Guidelines, in contrast, would be both appropriate and helpful. In this regard, the FCC should note that, unless "overhead" (that is, joint and common) costs are avoided in wholesale marketing, they should not be excluded from retail rates for purposes of resale (§ 180). In reality, carriers almost certainly will not avoid any joint and common costs in making services available for resale, since these costs by definition are not attributable to a particular service. Put another way, carriers will not reduce their

⁷⁹ In addition, detailed FCC regulation in this area is unnecessary. The statute itself declares that a "State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested excluding the portion thereof attributable to any . . . costs that will be avoided by the [LEC]" § 252(d)(3). The starting point for application of the pricing standard is clearly identified -- the "retail rate." To establish the "wholesale rate," the statute further provides that "avoided costs" are to be excluded. This precise formulation, together with the FCC's limited role with respect to pricing generally, renders the majority of the questions raised in the *NPRM* irrelevant (§§ 179-183).

overhead simply because a portion of services that had been provided at retail is now being provided through a reseller.

Similarly, the agency should state that ILECs may be permitted to recover new costs incurred by making a service available for resale.⁸⁰ Consideration of any such increased costs is necessary to ensure that the ILEC is not denied the opportunity fully to recover its costs of providing the resold service.⁸¹ Any other approach would risk both constitutional infirmity and serious repercussions for competition and the public interest. Moreover, recovery of actual costs is essential for the creation of an efficient telecommunications market. If resellers may purchase telecommunications services at wholesale rates that are below actual costs, they will tend to overconsume those services and distort the market.

F. Reciprocal Compensation.⁸²

The FCC asserts that it is "authorized to promulgate rules to guide the states" in implementing the mandate of § 251(d)(5) that ILECs "establish reciprocal compensation arrangements for the transport and termination of telecommunications" (¶ 226). As explained above, however, the appropriate role for the FCC is, at most, to identify a

⁸⁰ Costs associated with resale will be generated, for example, by the need for system modifications to accommodate a new entity as the customer of record. Such modifications will include changes to the circuit record-keeping system, the billing system (to allow separate bills for the resold local service and any services billed to the end user rather than the new entrant), and the automated work assignment system used for repair activities.

⁸¹ The FCC has previously ensured that ILECs recover costs associated with regulatory imperatives. See, e.g., 47 C.F.R. §§ 69.4(d), 69.107 (1995) (equal access cost recovery).

⁸² This section of GTE's Comments responds to Part II.C.5 of the *NPRM*.

range of acceptable outcomes without constraining either the discretion of affected parties to negotiate other arrangements, or the authority of states to review such agreements.⁸³ Potential outcomes for several issues related to reciprocal compensation are discussed below.

GTE agrees with the FCC's tentative conclusion that § 251(b)(5) applies to traffic transiting the networks of ILECs competing in the same service area as well as traffic passing between ILECs and CMRS providers (§ 230). The FCC should recognize, however, that parties and states will need to determine the local service area within which the compensation right applies. Each local service provider may well adopt a different service area definition for purposes of retail sales to end users. This will occur for several reasons, including the potential impact on numbering resources if new entrants are required to use the same service area definition as the ILEC. Service areas established for pricing purposes, however, need not be identical to those established for purposes of inter-company compensation. Determination of geographic areas for compensation should be left for the individual parties to negotiate.

⁸³ The FCC's request for comment (§ 234) on whether it should establish pricing methodologies, ceilings, or floors "to guide the states in setting the charge for the transport and termination of traffic" thus misapprehends the agency's proper role in implementation of the 1996 Act. The statute specifically anticipates that there may be a variety of "*arrangements* that afford the mutual recovery of costs," whether through offsetting of reciprocal obligations or otherwise. See § 252(d)(2)(B)(i) (emphasis added). The differences in such arrangements could be substantial, given the likely wide disparities in the networks and service areas of competitive and ILECs as well as state regulatory regimes. Moreover, any attempt by the FCC to establish price ceilings or floors would be likely to run afoul of the 1996 Act's express denial of any authority to the FCC "to establish with particularity the additional cost of transporting or terminating calls" (§ 252(d)(2)(B)(ii)). Accordingly, any costing or compensation standards adopted by the FCC in this proceeding should identify acceptable but not necessary outcomes under the 1996 Act.

The FCC should allow "transport" and "termination" to be separately priced (§ 231). Consistent with the FCC's limited role in implementing §§ 251 and 252, it should not foreclose any potential rate structures for reciprocal compensation. Indeed, the 1996 Act itself appears to contemplate any voluntarily agreed-to pricing system, from "no charge" under bill and keep to reasonably cost-based rates, (see § 252(d)(2)). Thus, parties to reciprocal compensation arrangements should be permitted, but not required, to establish separate charges for transport and termination, subject to state review if required.

The FCC can readily eliminate any confusion about the application of the different pricing standards for transport and termination and unbundled network elements (§§ 232-233). To do so, it should state that, where an interconnecting party purchases elements of an ILEC's network in order to provide exchange and exchange access service to its own end users (including the termination of traffic), the network element pricing standard would apply. Concomitantly, where an interconnecting party turns over traffic to an ILEC at a meet point or central office for termination of that traffic to the ILEC's end users, the reciprocal compensation pricing standard would apply. Any remaining ambiguity in such arrangements can and should be addressed in the parties' interconnection agreements, subject to state review.

Reciprocal compensation should be predicated upon cost-based rates (§§ 235-238). The 1996 Act requires that rates for transport and termination be based upon "a reasonable approximation of the additional cost of terminating . . . calls" as required by the 1996 Act (§ 252(d)(2)(A)(ii)). While this standard does not permit a costing proceeding, the FCC should permit states to determine that each individual LEC's rates

must be the same for all interconnecting parties, unless there is a reasonable basis for distinguishing among interconnectors (such as different traffic flows or transport mileage).

Bill and Keep arrangements should not be mandated (§§ 239-243). The *NPRM* seeks comment on whether the FCC or the state commissions have authority under the 1996 Act to impose Bill and Keep arrangements. A review of the 1996 Act shows clearly that the FCC has no authority to impose Bill and Keep, and that state commissions may impose Bill and Keep only (if at all) in narrowly circumscribed situations. FCC-mandated Bill and Keep would contravene §§ 251 and 252 in at least three respects:

First, § 252(a)(1) provides that an ILEC and a requesting carrier may enter into an agreement "without regard to the standards set forth" in §§ 251(b) and (c). In short, the parties to an interconnection agreement are free to override the statutory duties placed on ILECs under §§ 251(b) and (c). There could hardly be any clearer proof that privately negotiated arrangements lie at the heart of the 1996 Act's interconnection regime. If the FCC were to mandate Bill and Keep, it would deprive the parties of their fundamental right to negotiate their own arrangement.

Second, where the parties are unable to negotiate their own arrangement and invoke the state commission as arbitrator, § 252 authorizes the state commission to arbitrate a reciprocal compensation arrangement. The state commission may select any arrangement that provides for the mutual and reciprocal recovery by each carrier of costs associated with transporting and terminating calls originating on the other carrier's network. (§ 252(d)(2)(A).) Only if the state commission "fails to act to carry

out its responsibility" may the FCC preempt it. (§ 252(e)(5).) If the FCC were to mandate Bill and Keep, it would deprive the state commission of its power under § 252 to customize compensation arrangements.

Third, even a state commission can impose Bill and Keep only where it "afford[s] the mutual recovery of costs through the offsetting of reciprocal obligations."

(§ 252(d)(2)(B)(i).) This provision shows that the 1996 Act accords parties a substantive right to recovery of costs. If the FCC were to mandate Bill and Keep (either across-the-board or in any category of agreements), it would trample this substantive right.

FCC adoption of a Bill and Keep mandate would also violate the Fifth Amendment by requiring interconnection -- physical occupation and use -- of the ILEC=s network without just compensation. There can be no doubt that mandated interconnection is physical occupation of the ILEC's network. Mandatory interconnection involves not only *interconnection with*, but *carriage upon*, the existing ILEC network. Thus, there is the *physical taking* of an ILEC's property by other local service providers being granted mandatory access to, and carriage over, (limited capacity) closed transmission paths. By governmental fiat, the ILEC has no alternative but to open its network to *use* by another carrier. The other carrier's signals are transmitted *on* the ILEC's network. These signals *physically occupy* the ILEC=s network in the same manner that a property owner having an easement for ingress and egress may physically occupy the driveth of an adjacent property owner in order to traverse the space from his home to a public roadway. In each instance, the servient tenement -- be it adjacent property owner or ILEC -- must be compensated.

Under Fifth Amendment jurisprudence, physical occupation constitutes a *per se* taking. "[A] permanent physical occupation authorized by government is a taking without regard to the public interest that it may serve."⁸⁴ Mandatory interconnection falls squarely within this *per se* rule. Therefore, the ILEC must receive *just* compensation. However, a Bill and Keep arrangement mandated by a regulatory agency provides for no *just* compensation. Indeed, whether an ILEC will receive anything at all is a matter of speculation having no basis in fact. As § 252 of the 1996 Act makes clear, in interconnection situations there should be Amutual and reciprocal recovery of costs@ which are determined Aon the basis of a reasonable approximation of the additional costs of terminating [the] calls.@ Under a mandatory Bill and Keep arrangement, there is neither Amutual and reciprocal recovery of costs@ nor even reasonable (as opposed to speculative) approximation of additional cost. Thus, even if the FCC had jurisdiction to mandate an interconnection compensation scheme under the 1996 Act -- which it does not -- Bill and Keep would not meet the test of § 252 let alone the just compensation requirement of the Takings Clause of the Fifth Amendment.

There is another far more practical reason to avoid a Bill and Keep interconnection arrangement -- under today's network configurations, it will be virtually impossible to police compliance with a Bill and Keep arrangement for strictly local service traffic. For example, the largest interexchange carrier, AT&T, has publicly

⁸⁴ *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 427 (1982). In *Loretto*, the Court referred to cable system infrastructure (*i.e.*, "closed transmission paths", see definition at 47 U.S.C. § 522(7)) as a "cable 'highway'" which had been invaded. In the same manner, the incumbent LEC's networks are invaded through mandatory interconnection and carriage of the other local service provider's signals.

announced plans to enter the local service market in every state. When local traffic is terminated without charging the interconnecting entity and other traffic is subject to either state or Federal access charges, it is clear that a party providing these services will have an incentive to claim that as much of the traffic as possible is local.

Given these factors, the FCC can not mandate Bill and Keep. Rather, it should find that an acceptable outcome for terminating compensation is an arrangement commonly known as an Originating Responsibility Plan ("ORP"). Under an ORP, the carrier serving the customer who originates the call is responsible for seeing that the call is completed and that other firms involved in either transporting or terminating the call receive compensation for use of their networks and the services they provide.⁸⁵ The originating firm is also responsible for collecting the revenues from the originating customer. An ORP allows all firms involved in originating, transporting and terminating a call to receive just and reasonable compensation.

IV. ANY FCC PRICING GUIDELINES MUST RECOGNIZE THE NEED TO RECOVER JOINT AND COMMON COSTS AND COSTS ASSOCIATED WITH UNBUNDLING.

As explained in section I of these Comments, GTE does not agree that § 251 of the 1996 Act permits the FCC to establish mandatory pricing standards that states must use in determining rates for interconnection and unbundled network elements. If the FCC does decide to identify acceptable, but not mandatory, pricing standards, however,

⁸⁵ An ORP arrangement is especially superior to a Bill and Keep plan in the case where an intermediate carrier is involved. For example, if a GTE customer placed a call to a MCI Metro customer located in the same community, and MFS provided transport between the two networks, MFS would receive no compensation because under the Bill and Keep arrangement no bills are created and no compensation is provided between any firm.

it must recognize that any standard based purely on Total Service Long Run Incremental Cost (TSLRIC) (see ¶¶ 128-30) would prevent ILECs (or any firm) from providing economically efficient levels of service and earning a reasonable profit.⁸⁶ This analysis is described in more detail in the attached Affidavit of Dr. Edward C. Beauvais ("Beauvais Affidavit").

The 1996 Act does not dictate use of TSLRIC or any other specific pricing standard. Rather, it manifests a congressional desire that competition for local exchange service be promoted by establishing efficient and compensatory prices and terms for interconnectors to use ILEC networks to compete in providing exchange services.⁸⁷ Congress recognized that the promotion of competition requires a delicate balance so that interconnectors and ILECs alike pay reasonable and non-discriminatory prices, and that all firms receive compensation adequate for maintaining and expanding the public switched network.⁸⁸ To this end, § 252(d) requires only that rates for unbundled network elements be based on cost (and not based on a rate of return or

⁸⁶ Definitions for the various economic terms used in the *NPRM* (¶ 126) are contained in Attachment 2.

⁸⁷ Efficient pricing also depends on negotiated agreements and state commission pricing decisions that deaverage interconnection rates, as well as end user pricing, within traditional study areas (see ¶ 133). Current study area pricing averages costs across a wide variety of geographic areas that exhibit markedly different cost and demand characteristics. Efficient pricing and the promotion of competition require that these characteristics be taken into account in establishing interconnection rates. Such an approach has already been endorsed by the FCC in allowing ILECs to set transport rates based on density zones. See Beauvais Affidavit at 13-15.

⁸⁸ In this regard, the FCC must not lose sight of its section 1 obligation to "make available . . . a rapid, efficient, nation-wide and world-wide wire and radio communication service with adequate facilities at reasonable charges."

rate base proceeding) and non-discriminatory, and permits ILECs to earn a "reasonable profit."⁸⁹ In order even to begin to discern whether a service produces a reasonable profit, a reasonable measure of joint and common costs in addition to the service's incremental cost must be recovered in rates for interconnection services and network elements.

A. ILECS Must Be Able to Recover Joint and Common Costs in Order To Remain in Business.

Telephone companies, like all firms, have joint and common costs that must be recovered on a going forward basis in order to remain in business. In light of the presence of substantial joint and common costs, the requirement that rates be based on cost precludes use of LRIC or TSLRIC as a prescriptive maximum price because the carrier, by definition, would be prevented from recovering all of its costs, in particular, its joint and common costs. The recovery of these costs is fundamental to the ability of ILECs to continue to utilize efficiently their substantial investment in the public switched telephone network for the critical communications needs of the country.

The sum of all revenues produced by the pricing of network elements at LRIC or TSLRIC would not produce sufficient revenues to recover all relevant costs. In order for a multi-product firm to remain profitable, the revenues from all its services must recover the firm's total costs. See Beauvais Affidavit at 3-4, 7-13. Therefore, it is essential that

⁸⁹ "Profit" does not simply mean that overheads (joint and common costs) are recovered. Rather, overhead is an element of cost, and should be recovered as such. Profit is that portion of revenue, above and beyond cost recovery, that produces a return on investment.

a portion of joint and common costs be recovered in addition to TSLRIC in the pricing of telecommunications services and network elements.⁹⁰

The problem of recovering joint and common costs is exacerbated as networks are broken into smaller and smaller pieces. The greater the degree of unbundling, the fewer costs that may be directly assigned to each unbundled element, and the greater the amount of unrecovered joint and common costs. A simple example can illustrate this point. Assume that Nike, which manufactures shoes, is required to sell at incremental cost any component of a pair of Nike shoes. One firm may ask to purchase only left, but not right, shoes, arguing that the incremental cost of its purchase is only the raw materials (leather and rubber) required for production, but not the manufacturing plant and equipment, which would have been built and maintained by Nike anyway for its own use. Similarly, another firm may ask to purchase only right, but not left shoes, again arguing it should pay only for the incremental raw materials. Finally, a third firm may ask to purchase only the legal right to use the Nike name on non-Nike-made shoes, but not any shoes themselves.

Working together, the three firms can combine to sell Nike shoes that are just like those supplied by Nike, but the combined cost to the three firms will be only the raw materials and will exclude the cost of the Nike factory, the value of the Nike name, and so forth. If such pricing were mandated, Nike would rapidly cease production and sell its assets for other uses, thereby preventing the three firms to which it was selling from

⁹⁰ ILECs, of course, will be unable to recover these joint and common costs from retail services because the 1996 Act's mandate that there be local service competition will constrain upward pricing. Therefore, any pricing rule that the FCC endorses must permit recovery of joint and common costs.

competing as well. Thus, such a pricing rule is in no firm's long-run interest, even though, if these implications are not considered, the short-run benefits to competitors and consumers may appear attractive.

B. Ramsey Pricing Is the Preferred Means of Permitting LECs to Recover Joint and Common Costs.

As the FCC noted (§ 130), a variety of methods can be employed to enable an ILEC to include a reasonable share of joint and common costs in the pricing of interconnection and unbundled network elements. Of the methods cited, however, only the Ramsey pricing method would produce (1) an approximation of reasonable and efficient rates for interconnectors that would enable competitive entry, (2) a constitutional level of compensation for ILECs,⁹¹ and (3) rates that comply with the mandates of the statute.⁹²

Ramsey pricing begins with forward-looking costs based on TSLRIC, then establishes relative price mark-ups for the recovery of joint and common costs across network elements based on demand elasticities for the individual elements. It is a well-recognized conceptual economic method of pricing a range of services in situations where pricing at incremental cost produces insufficient revenues to cover the total cost of providing the services demanded. This is precisely the situation that ILECs face currently, which will only intensify as competition grows. Due to the pattern of

⁹¹ See section IV.D, *infra*.

⁹² In addition to Ramsey pricing, the Efficient Component Pricing Rule ("ECPR") is a rational method for developing efficient and compensatory wholesale and unbundled network element price sets. See *An Empirical Analysis of Pricing Under Sections 251 and 252 of the Telecommunications Act of 1996* included with this submission.

competitive entry from substitutable service providers for network elements, ILECs cannot efficiently recover all their common costs by distributing a *pro rata* share of such costs to each of their unbundled network elements in an across-the-board manner. Those elements that are most subject to competition will be able to recover a relatively smaller portion of joint and common costs; those subject to relatively less rivalry in supply will be able to make a larger contribution to the recovery of efficiently incurred common costs. A legitimate pricing standard must permit an ILEC to use Ramsey pricing (or other forms of second-best rules) in order to have an opportunity to recover its common costs. See Beauvais Affidavit at 4-8.⁹³

C. Other Proposals that Would Prevent Cost Recovery Should Not Be Adopted.

The *NPRM* seeks comment on certain other proposals, in addition to TSLRIC that would unreasonably prevent full cost recovery by ILECs. For example, the FCC inquires whether to adopt a narrowly defined "imputation rule" that would require the sum of all rates for unbundled network elements not to exceed the retail price of the corresponding end user service (§ 184). As described previously, such a rule would ignore the significant costs associated with unbundling the network and the additional

⁹³ The FCC notes that it could minimize cost recovery concerns by identifying a "substantial portion of costs as incremental to a particular service or element (§ 130)." As the FCC recognizes, however, the feasibility of such an approach may depend on the degree to which network elements are unbundled. If more granular unbundling is required, minimization of joint and common costs would require defining network outputs at a higher level of aggregation (e.g., loop, switching, transport), so that a larger share of joint and common costs will be included in the estimation of TSLRIC. GTE would support a finding that this option is acceptable if it in fact leads to the same level of recovery of joint and common costs as the Ramsey methodology mentioned above.

costs associated with providing the unbundled elements to interconnectors. Moreover, because some retail rates are already less than cost, the ceiling price established by an imputation rule would be inadequate even assuming no additional costs were engendered by unbundling.⁹⁴

For similar reasons, GTE strongly objects to FCC adoption of an interim pricing rule that would be based on short run incremental costs in order to provide an incentive to reach a rapid agreement with interconnectors (§ 132). Unbalancing the negotiation process by placing an economic gun in the hands of a competitor would produce inefficient pricing and, as discussed below, would lead to unconstitutionally confiscatory rates.

D. Failure To Allow Recovery of Joint and Common Costs and of Costs Associated with Unbundling Would Violate The Takings Clause.

Because the pure TSLRIC, narrowly defined imputation, and interim pricing proposals would prevent reasonable cost recovery, they would trample fundamental constitutional guarantees. "[T]he Takings Clause of the Fifth Amendment" is "as much a part of the Bill of Rights as the First Amendment or Fourth Amendment."⁹⁵ *Dolan v. Tigard*, 114 S. Ct. 2309, 2320 (1994). The Supreme Court has emphasized that, as a *per se* matter, at least two categories of government action represent takings: (1) "regulations that compel the property owner to suffer a physical 'invasion' of his

⁹⁴ Notably, the FCC acknowledged this critical problem with regard to imputation when it noted that "[i]t may be difficult to comply with an imputation rule . . . if rates for retail services are below cost, due to implicit, non-competitively neutral, intrastate subsidy flows" (§ 185).

⁹⁵ The Takings Clause provides that "private property" shall not "be taken for public use, without just compensation." Amend. V.

property" and (2) regulations that deny "all economically beneficial or productive use of [property]." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015 (1992).

Beyond these *per se* categories, the Takings Clause also bars government action that requires private parties to utilize their property for public use, but only permits the owner to recover an inadequate fee. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989); see also *id.* at 317 (Scalia, J., concurring, joined by White and O'Connor, JJ.). In such a case, the government regulations are "confiscatory," *id.*, and impermissibly mandate a subsidy from the owner to the public or to other private parties.

As shown below, the challenged proposals would constitute unconstitutional takings. *First*, because each proposal would require use of the ILEC's physical property, each would trigger an obligation to provide just and reasonable compensation -- an obligation that would not be satisfied by the below-cost methodologies. *Second*, because each proposal would amount to a "confiscatory" rate, each would violate the Takings Clause.

1. The Challenged Proposals Constitute Per Se Takings Because They Mandate Physical Use of Property Without Just Compensation.

GTE unquestionably has property rights in the switches, loops, and transmission wires that make up its local telephone infrastructure. Property rights have been described as the right "to possess, use and dispose" of property. *United States v. General Motors Corp.*, 323 U.S. 373, 378 (1945). To the extent that the government requires GTE to allow third parties to occupy GTE's property through transmission of competitors' signals, the government significantly impinges upon each of these rights. "When faced with a constitutional challenge to a permanent physical occupation of real

property, [the Supreme] Court has invariably found a taking" that requires just compensation. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 427 (1982) (mandated installation of a coaxial cable is an unconstitutional taking). Physical occupation of property thus is a *per se* taking and, where permanent, automatically requires just compensation. *Id.*; see also *Lucas*, 505 U.S. at 1015. An occupation is "permanent," moreover, when it may last for the duration of the applicable legal regime. *Id.* at 439. This *per se* rule is applicable even where the physical intrusion is "minor" or "minute." *Id.* at 421; *Lucas*, 505 U.S. at 1015. See also *GTE Northwest, Inc. v. Public Utility Commission*, 900 P.2d 495, 501 (1995) (holding that collocation rules would effect a taking under *Loretto*), cert. denied, ___ S. Ct. ___, 1996 WL 26525 (Apr. 22, 1996).

The forced occupation of GTE's property is essentially no different from requiring a railroad to carry certain cargo or cars, or a trucker to carry a particular load. GTE will have no right to physically occupy the lines only with its own transmissions, nor can GTE exclude other carriers from its infrastructure. The government-mandated physical occupation of GTE's infrastructure by competitors therefore denies GTE power to control the use of its property. The power to exclude has traditionally been considered "one of the most essential sticks in the bundle of rights that are commonly characterized as property." *Kaiser Aetna v. United States*, 444 U.S. 164, 176 (1979).

This physical occupation requires just and reasonable compensation to GTE. Because the challenged proposals do not allow GTE to recover its costs, they fail to provide adequate compensation. Imputation, by its plain terms, does not permit GTE